GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Iowa, New Mexico, Arizona, Texas, Idaho, Washington, and California!

A PERSONAL NOTE FROM JEFF GERRISH

As most *Musings* readers are aware, approximately two years ago on September 1, 2023, our partner, Philip Smith's, youngest son, Wes, a 21 year old student at TCU in Fort Worth, Texas, was murdered in an unprovoked, random act of violence. Last Thursday, the murderer, also a 21 year old at the time, Matthew Purdy, reached a plea agreement with the State (as approved by the Smith family) and pled guilty to the murder as well as nine other felonies he had committed prior to the murder. Purdy received a 60-year sentence for the murder, and the combination of that sentence plus the other nine felonies gave him a total prison term of 206 years, to be served in the Texas State prison system. While the Smith family and the rest of us continue to mourn the loss of Wes, the Smith family is happy to be able to put this criminal piece behind them and to get this dangerous criminal where he will not be able to hurt anyone else (other than his fellow inmates). For further information, a link to the NBC news story is provided here: NBC News Story. If you would like to communicate directly with Philip Smith, please use his office email at psmith@gerrish.com.

HOLDING COMPANIES AS INSURANCE

Our firms have helped hundreds of community banks form bank holding companies. Our general recommendation is to form it when you don't need it. That way, when you do need it, it is available without having to go through the Federal Reserve formation and approval process. It is always surprising to us how many community banks have not yet taken advantage of this beneficial structure.

We recently had an interesting discussion with the Board of Directors of a community bank that does not have a bank holding company. The Board is considering a holding company and asked if we could talk through the holding company structure, reorganization process, and ultimate benefits with them. Of course, we were happy to oblige.

The reality of the situation is that the bank does not presently need a bank holding company. It currently has plenty of capital, with a Tier 1 Leverage Ratio in excess of 12%, and no significant shareholder liquidity demands that are unmet. However, the Board sees the liquidity issue may change down the road. The bank has an aging shareholder base, and the Board anticipates increased demand for stock liquidity at some point in the not-too-distant future.

In talking through all of this, the Board recognized the holding company is best currently thought of as an insurance policy. There is no current need for the holding company, but they expect it will be needed at some point in the future. As we discussed with the Board, a holding company is like an insurance policy - if you wait until you need it, you have waited too long.

ESOPs AS LIQUIDITY STRATEGIES

Over the past couple of months, we have received half a dozen or so inquiries about ESOPs from community banks that are essentially in the same position. These ESOP inquiries are, for the most part, from smaller community banks that are looking for strategies to remain independent while also providing stock liquidity for larger shareholders that are advancing in age. Each bank seems to be looking for the same general thing, which is a strategy to buy the shareholder out while remaining independent.

Employee Stock Ownership Plans ("ESOP") are a strategy that these banks are considering. The general thought is to put an ESOP in place and either leverage the ESOP or provide it with 401(k) features to get cash into the ESOP to purchase the aging shareholders' common stock. That stock will then be owned by the ESOP and allocated to the underlying employees in accordance with the terms of the ESOP.

An ESOP is a qualified retirement plan. It is not a simple strategy that can be implemented overnight. That said, if utilized properly, it is a solution to a need for stock liquidity that supports ongoing independence. For community banks in a certain set of circumstances, it likely makes a lot of sense. It is basically swapping out your existing shareholders for employee shareholders. Not a bad deal.

SUBCHAPTER S IS ALIVE AND WELL

We have often used *Musings* to address the benefits of Subchapter S. In 2017 (hard to believe approximately eight years ago), with the President Trump first term tax cuts, the benefit to Subchapter S for community banks was diminished due to the cut in the corporate tax rate versus individual tax rate. Our analysis at that point in time for community banks across the nation was, notwithstanding the tax cuts (particularly in view of the Section 199A income exclusion provided), that Subchapter S on balance was still one of the best mechanisms to continue to meet the Board of Directors' obligation to enhance shareholder value.

In connection with Trump's second proposed round of tax cuts in the "One Big Beautiful Bill," Subchapter S will be further enhanced by changing the income exclusion from 20% to 23% if the Bill passes in its proposed form. This will further enhance Subchapter S for community banks.

Approximately half of the banks in the country operate under Subchapter S of the Internal Revenue Code. We have recently (probably due to the publicity from Trump's One Big Beautiful Bill) received multiple inquiries regarding Subchapter S. Our advice is always the same – the Board should at least consider this strategic alternative, review how a conversion to Subchapter S would impact positively or negatively the bank's long-term strategic initiatives, and review how Subchapter S would impact the holding company's shareholders at various individual tax rates. No surprise – we have the financial models that can assess that for the Board. Let us know how we might help.

STABLECOINS

In the most recent edition of *Musings*, we addressed the potential problem of "disintermediation" posed by cryptocurrency. As a quick reminder, the concern of disintermediation is one of removing banks from financial transactions and instead replacing the banks with transactions on the blockchain. This is what is referred to as "decentralized finance" in today's lingo.

Over the past two weeks, there has been some pretty significant action in Washington as it relates to stablecoins. If you are not familiar, stablecoins are a type of cryptocurrency but are a little bit different than Bitcoin, which, of course, is the most notable cryptocurrency.

Many people will tell you their concern with Bitcoin is its volatility. Bitcoin owners do not know exactly what Bitcoin is going to be worth at any point in the future because the value of one Bitcoin is constantly fluctuating. Stablecoins are intended to address this concern. Simply put, a stablecoin is a cryptocurrency that is intended to have a stable value because the value of the currency is pegged to a fiat currency, which in the United States would be our dollar. The whole idea of stablecoins is to remove the volatility that is present in Bitcoin and instead have a cryptocurrency that has a constant asset value.

The United States Senate recently approved its version of the GENIUS Act, which is legislation that is designed to address stablecoins. A summary of the Act is beyond the scope of *Musings*. If you are not familiar, we do recommend you take some time to read up on these issues and begin to understand how they might affect community banking.

CRYPTO LOANS

As noted above, it seems the vast majority of discussion regarding cryptocurrency involves the use of cryptocurrency in the "payment space." In other words, crypto is thought of as a new form of digital currency that will act as consideration in transactions involving the exchange of goods or services. As noted above, that is a disintermediation risk (among others) to community banking.

What is discussed less, however, is the use of crypto in the "lending space." We do not hear much discussion about companies that are involved in lending to borrowers to acquire crypto, lending secured by crypto, or the use of lending with crypto as an asset to complete a transaction. There are some companies that are out there that are working towards this (or somewhat doing it now), but it is not a major part of the discussion yet.

There is certainly a risk that at some point in the future there will be companies that are crypto depositories and lenders. These may be banks. They may be FinTechs or quasi-banks. We do not know exactly what it will look like, but we do anticipate this will be a new type of competition at some point in the future.

THE NEXT GENERATION OF COMMUNITY BANK LEADERSHIP

As we have often noted in *Musings*, succession of management is a critical issue to be assured (not micromanaged) by the community bank Board of Directors. Typically, a Board's involvement is to address the issue of who should be the successor to the current President/CEO or similar position. The President/CEO should be concerned about succession throughout the organization. This often involves the identification of what we typically refer to as "emerging leaders" in the organization. With respect to the many Emerging Leaders Studies that our firms have conducted, once the senior management has identified potential emerging leaders throughout the organization, we will generally, through interviews, explore with those emerging leaders their desires, goals, long-term career path, and the like. That is only half the equation, however. The other half is making sure these individuals are "trained up" in the way they should go. This often involves internal mentoring at the bank, but it is also often involves programs offered through entities other than the bank, such as graduate schools of banking, the state bank trade associations, and the like. We certainly believe that leadership "can be taught." It does not happen overnight, and often to teach an individual in a community bank to be a leader requires some outside expertise and mentoring. Food for thought.

THE SMOOTH CLOSING

Over the past couple of weeks, we closed a branch acquisition transaction. In the deal, we were representing the bank that was acquiring another community bank's branch location. In advance of the closing, our client asked us what they should expect in terms of activity on the actual date of closing. Our response was "not much," if we do our job correctly.

We are proud to report that, in our view, we did our job correctly. The closing was essentially a non-event. All of the transaction closing documents were exchanged a couple days prior to closing. On the actual date of closing, we dedicated about 10 to 15 minutes to the deal. That was really just a discussion with the lawyer on the other side of the deal confirming all of the closing items and directing the release of closing documentation from escrow. The selling bank wired funds to the buyer, and it was all over for that day.

This deal closing was more like most than some people realize. The closing of an acquisition transaction, at least from the legal perspective, is often a non-event. It should not be some significant, drawn out process to get the deal closed on the legal side. All the heavy lifting is done before the actual date of closing.

Although the deal closing does not have much fanfare from a legal perspective, that does not mean nothing happens on the date of closing. You often have data conversion, signage changes, employment changes, and similar considerations that require activity and effort to get fully closed and the target properly integrated.

ICBA ENHANCING ORGANIZATIONAL VALUE CONFERENCE

On July 31 through August 1, 2025, the ICBA is providing its second annual Enhancing Organizational Value Conference at The Westin Edina Galleria hotel in Edina, Minnesota. Philip Smith and Greyson Tuck will be the presenters/instructors. This is an in-person, two-day conference that will focus on many of the strategies often addressed in *Musings*. This will include a detailed interactive discussion on strategies for community banks to create value, such as stock liquidity, capital raising and deployment alternatives, succession planning, employee attraction and retention, equity and equity-like compensation, mergers and acquisitions, and others. To check out further details and register for the conference, please visit the following link: ICBA Enhancing Organizational Value Conference - July - Edina MN

CONCLUSION

It's hard to believe the end of the second quarter is upon us. This will be the last *Musings* before the July 4th holiday weekend. We hope all *Musings* readers enjoy the 4th of July weekend with family and friends.

Stay safe. See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

Upcoming Webinars and In-Person Presentations

- July 7-9, 2025 – Community Bankers Association of Kansas, 2025 Annual Convention & Trade Show at the Kansas City, Missouri Marriott Downtown (In-Person Event) (July 8) (Philip K. Smith, Presenter) Registration: CBA Kansas Annual Convention

- July 13-25, 2025 – Graduate School of Banking at Colorado, Class: "Enhancing Shareholder Value" (July 14-18) (Greyson Tuck, Instructor) Registration: Graduate School of Banking at Colorado

- July 27 – August 8, 2025 - Graduate School of Banking at the University of Wisconsin-Madison. "Enhancing Shareholder Value With or Without a Sale" (July 28-29) (Philip K. Smith, Instructor) Registration: [GSB-Wisconsin]

- July 31-August 1, 2025 - Independent Community Bankers of America, Enhancing Organizational Value Conference at The Westin Edina, Minnesota Galleria (In-Person Event) (Philip Smith and Greyson Tuck, Presenters) Registration: [ICBA Enhancing Organizational Value Conference - July - Edina MN]

- August 12, 2025 - Independent Community Bankers of America – (Webinar) "Keys to Being a Great Outside Bank Director" (Greyson Tuck, Presenter) Registration: [ICBA Webinar - Keys to Being a Great Outside Bank Director]

- August 12, 2025 – Community Bankers of Washington, Northwest Virtual Conference Series "Creating Value in an M&A Environment" (Philip Smith, Presenter) Registration: [Community Bankers of Washington Northwest Virtual Conference]

- August 12-14, 2025 - Independent Community Bankers of America, Credit Analyst Institute (Livestreamed Event) (August 13) (Doc Bodine, III, Instructor) Registration: [ICBA Credit Analyst Institute - August Livestreamed]

- August 17-29, 2025 - Pacific Coast Banking School. "The Board, Shareholder, and M&A: Legal and Practical Concerns" (August 18-22) (Philip Smith, Instructor) [Pacific Coast Banking School]

- September 16-19, 2025 – Community Bankers of Washington, 2025 CBW Annual Membership Convention and Trade Show at The Historic Davenport Hotel, Spokane, Washington "Independence, Directors & Shareholders: Everything You Need To Know!" (Sept. 18) (Philip Smith, Presenter) Registration: [CBW Annual Convention]

- September 18-20, 2025 – Community Bankers Association of Illinois, 51st Annual Convention & Expo at the Kansas City Marriott Downtown, Kansas City, Missouri "Ten "Impossible Things Directors Must Do" (Sept. 19) (Philip Smith, Presenter) Registration: [CBAI Annual Convention]